REPORT OF EXAMINATION
OF THE

INDEMNITY COMPANY OF CALIFORNIA

AS OF
DECEMBER 31, 2004

Participating State
and Zone:

California

Filed April 5, 2006

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Los Angeles, California
December 14, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Gary L. Smith
Secretary, Zone IV-Western
Director of Insurance
Department of Insurance, State of Idaho
Boise, Idaho

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

INDEMNITY COMPANY OF CALIFORNIA

(hereinafter also referred to as the Company) at the primary location of its books and records, 17780 Fitch, Suite 200, Irvine, California 92614.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

SUBSEQUENT EVENTS

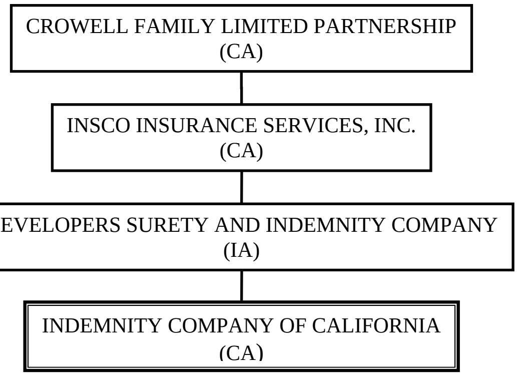
On November 23, 2005, the Company sold its home-office property to an unrelated party pursuant to a sale-leaseback arrangement. The Company owned 20% of the home office property while its immediate parent, Developers Surety and Indemnity Company (DSIC) owned 80%. The $9 million total consideration for the sale, resulted in a substantial gain, and was split between the companies in the above percentages. Concurrent to the property sale, the Company's ultimate parent, INSCO Insurance Services, Inc., entered into a two-year operating lease on the same property with the new owners.

COMPANY HISTORY

During the period covered by this examination there were no amendments to the Company's articles of incorporation or bylaws. On March 31, 2003 the Company paid an "ordinary" cash dividend in the amount of $800,000 to its parent company, Developers Surety and Indemnity Company.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



(all ownership is 100%)

Management of the Company is vested in a four-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

Directors

Name and Residence	Principal Business Affiliation
Harry C. Crowell Newport Beach, California	President, Chief Executive Officer and Chairman of the Board INSCO Insurance Service, Inc.
Walter A. Crowell Henderson, Nevada	Executive Vice President, Secretary and Vice Chairman of the Board INSCO Insurance Service, Inc.
David H. Rhodes LaQuinta, California	Chief Underwriting Officer INSCO Insurance Service, Inc.
David L. Kerrigan Newport Beach, California	Executive Vice President and Chief Legal Officer INSCO Insurance Services, Inc.

Principal Officers

Name	Title
Harry C. Crowell	President and Chief Executive Officer
Walter A. Crowell	Executive Vice President and Secretary
Sam (nmn) Zaza	Chief Financial Officer and Treasurer
David L. Kerrigan	Executive Vice President
David H. Rhodes	Executive Vice President
Wesley W. Cowling	Senior Vice President
Susan M. Moore	Senior Vice President
Gregg N. Okura	Vice President
Daniel E. Young	Vice President
Steve A. Tvedt	Vice President

Management Agreements

Underwriting Management Agreement: The Company maintains an underwriting management agreement with its ultimate parent, INSCO Insurance Service, Inc. (INSCO). Under the terms of the agreement, INSCO provides administration services, production and claims adjusting services. The enabling agreement specifies that the Company will reimburse INSCO for all costs and expenses incurred on behalf of the Company. During 2004 management fees totaling $2,481,996 were paid by the Company. This agreement was replaced by a new agreement (also on a cost reimbursement basis), effective August 1, 2005. It is recommended that the Company submit this new agreement to the California Department of Insurance (CDI) for approval.

Tax Sharing Agreement: The Company participates in a federal income tax allocation agreement with INSCO and other affiliates. The consolidated tax liability is allocated among the members based on each member's computation of its separate taxable income or loss. No supporting documentation was provided by the Company concerning the apparent submission of this agreement to the CDI pursuant to CIC Section 1215.5(b). It is recommended that the Company submit this agreement to the CDI for approval.

Investment Management Services Agreement: The Company entered into this agreement effective May 2000, with Madison Scottsdale, a non-affiliated investment counsel. Under the terms of this agreement, Madison Scottsdale provides investment supervision and direction for the fixed income investments of the Company.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Company was licensed to transact surety insurance only. The following is a listing of the states in which the Company is licensed:

Alaska	Nevada
Arizona	Oregon
California	South Carolina
Hawaii	Utah
Idaho	Virginia
Indiana	Washington

In 2004, the Company wrote $7.6 million of direct premiums. Of the direct premiums written, approximately $5.2 million or 68% was written in California, $1.4 million or 17.5% was written in Washington, and $1.0 million or 14.5% was written in the remaining states.

The Company's business is produced through INSCO Insurance Service, Inc. (INSCO) pursuant to the aforementioned underwriting management agreement. The underwriting and distribution network is administered by INSCO, which maintains various branch offices. INSCO provides all underwriting and support services for the Company and utilizes a distribution network of approximately 500 independent agents.

REINSURANCE

Assumed

The Company has no reinsurance assumed.

Ceded

The following is a summary schedule of the principal ceded reinsurance treaties inforce as of December 31, 2004:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
1st Excess of Loss	American Reinsurance Company – 60%	$500,000 each principal	$4.5 million in excess of $500,000
	XL Reinsurance America, Inc. – 40%		
2nd Excess of Loss	American Reinsurance Company – 60%	$5 million each principal	95% of $5 million in excess of $5 million
	XL Reinsurance America, Inc. – 40%		
3rd Excess of Loss	American Reinsurance Company – 60%	$10 million each principal	95% of $5 million in excess of $10 million
	XL Reinsurance America, Inc. – 40%		

A 50% surety surplus share treaty with American Reinsurance Company and Employers Reinsurance Corporation covering subdivision bond business, initially effective October 1, 1991, was placed into runoff on October 1, 2001.

An accident year aggregate stop loss treaty with American Reinsurance Company, initially effective January 1, 1992, was terminated and commuted effective December 31, 2004.

As of December 31, 2004, reinsurance recoverables for all ceded reinsurance totaled $624,000 or 8.6% of surplus as regards policyholders. All of the ceded reinsurance recoverables were from non-affiliated admitted reinsurers.

ACCOUNTS AND RECORDS

Information System Controls

A concurrent examination of the Developers Surety and Indemnity Company (DSIC), an Iowa-domiciled insurer, was conducted by the Iowa Department of Insurance (IDI). In conjunction with that examination, IDI reviewed the information systems used by the management services provider (INSCO), which is used by DSIC and the Company. The results of that information systems review indicated that a formal disaster recovery plan has not been completed. It is recommended that a formal disaster recovery plan be prepared and periodically tested.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Statement of Financial Condition
as of December 31, 2004

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 8,802,763	$	$ 8,802,763	
Stocks:				
Preferred stocks	151,451		151,451	
Real Estate: properties occupied by the Company	788,900		788,900	
Cash and short-term investments	2,539,896		2,539,896	
Investment income due and accrued	78,872		78,872	
Premiums, and agents' balances in course of collection	746,983		746,983	(1)
Reinsurance:				
Amounts recoverable from reinsurers	417,421		417,421	
Other amounts receivable under reinsurance contracts	571,430		571,430	
Net deferred tax asset	330,418	29,280	301,138	
Receivables from parent, subsidiaries and affiliates	102,237		102,237	
Aggregate write-ins for other than invested assets	77,912		77,912	
Total assets	$14,608,283	$ 29,280	$14,579,003	

Liabilities, Surplus and Other Funds			
Losses		$ 1,034,497	(2)
Loss adjustment expenses		556,757	(2)
Taxes, licenses and fees		16,513	
Current federal income taxes		455,041	
Unearned premiums		4,385,255	
Ceded reinsurance premiums payable		160,776	
Amounts withheld-retained by Company for account of others		466,792	
Payable to parent, subsidiaries and affiliates		15,000	
Payable for securities		250,000	
Total liabilities		7,340,631	
Common capital stock	$ 1,200,000		
Gross paid-in and contributed surplus	2,425,478		
Unassigned funds (surplus)	3,612,894		
Surplus as regards policyholders		7,238,372	
Total liabilities, surplus and other funds		$ 14,579,003	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income		
Premiums earned		$ 6,679,404
Deductions:		
Losses incurred	$ 566,564	
Loss expense incurred	495,533	
Other underwriting expenses incurred	4,699,830	
Total underwriting deductions		5,761,927
Net underwriting gain		917,477
Investment Income		
Net investment income earned	$ 456,799	
Net realized capital gains	90,374	
Net investment gain		547,173
Net income before dividends to policyholders and before federal income taxes		1,464,650
Federal income taxes incurred		520,737
Net income		$ 943,913

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		$ 6,265,657
Net gain	$ 943,913	
Change in net deferred income tax	78,082	
Change in nonadmitted assets	(29,280)	
Aggregate write-ins for gains and losses in surplus	(20,000)	
Change in surplus as regards policyholders		972,715
Surplus as regards policyholders, December 31, 2004		$ 7,238,372

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination			$ 5,433,273
	Gain in Surplus	Loss in Surplus	
Net income	$ 2,559,632	$	
Change in net deferred income tax	94,747		
Change in nonadmitted assets		29,280	
Dividends to stockholders		800,000	
Aggregate write-ins for losses in surplus		20,000	
Totals	$ 2,654,379	$ 849,280	
Net increase in surplus as regards policyholders			1,805,099
Surplus as regards policyholders, December 31, 2004, per Examination			$ 7,238,372

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Premiums and Agents' Balances in Course of Collection

The Company is not carrying its agents' balances that are 90-days or more overdue, as not-admitted assets pursuant to Statement of Statutory Accounting Principles (SSAP) No. 6. INSCO, the management services provider for the Company, collects premiums from the agents and remits the amounts (net of agent's commissions) to the Company on a monthly basis. INSCO contractually settles with the Company within sixty-days so the account is always deemed current. An analysis of the detailed agents' balances receivable at December 31, 2004 indicates approximately $114,000 of specific balances receivable that appear more than 90-days overdue. However, due to the immateriality of the amount, no examination change has been made. It is recommended that the Company report the agents' balances that are 90 days or more overdue, as non-admitted assets in all future financial statements.

(2) Losses and Loss Adjustment Expenses

Based on the review by a California Department of Insurance Casualty Actuary, the Company's December 31, 2004 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management Agreements – Underwriting Management Agreement and Tax Sharing Allocation Agreement (Page 4): No supporting documentation was provided by the Company evidencing a submission of the 2000 federal income tax allocation agreement, or submission of the new (August 1, 2005) underwriting management agreement, to the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.5(b). It is recommended that the Company submit these agreements to the CDI for approval.

Accounts and Records – Information Systems Controls (Page 7): The results of an information systems review indicated that a formal disaster recovery plan has not been completed. It is recommended that a formal disaster recovery plan be prepared and periodically tested.

Previous Report of Examination

Reinsurance – Ceded (Page 6): It was recommended that the Company amend its accident year aggregate stop-loss reinsurance agreement to comply with CIC Section 922.2 and with the CDI requirements regarding offset clauses. The aggregate stop-loss reinsurance agreement has been terminated and commuted during the current examination period.

Accounts and Records (Page 7): It was recommended that the Company review its information systems and make appropriate changes to strengthen internal controls. Certain control weaknesses apparently still exist but appear to result primarily from the relatively small size of the operation and limited personnel available for administration of control functions.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Gary McMurray, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California